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Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday August 8, 1980

This week interest rates worked down on balance, largely due to the influence of the spectacular drop in the Federal funds rate. By late in the week, the funds rate had returned to its approximate range of two weeks ago, before the market's fears of a tightening of the Fed's policy stance had set in. As we explored in some detail in last week's letter, there never was any hard evidence indicating the Fed had tightened its policy. Events this week confirmed that analysis.

In a word, the funds market was volatile. The background to the drama was that the Fed (according to our projections) needed to drain a modest amount of reserves in the statement week which began Thursday, July 31. However, the near-panicky market psychology, together with a likely failure of some banks to realize just how plentiful their reserves actually were, kept up the pressure on the funds market prior to the weekend, and the Fed very reluctantly supplied reserves through repurchase agreements. That, of course, meant an even greater reserve-draining job would have to be done after the weekend. In that setting, the Fed clearly expected the funds rate to soften--and it did! After opening at 10 3/8% Monday morning, funds traded off to the 8 1/2% range by late afternoon. On Tuesday, the rate plunged further to 2% late in the day--despite the Fed's aggressive draining through two rounds of reverse RPs. On Wednesday, the Fed drained some more with funds trading around 7 1/2%.

The new statement week which began on Thursday resembled the calm after the storm. Funds chugged along mostly in the 8 3/4% to 9 1/4% area, with everyone--including the Fed--apparently satisfied that reserve positions were about in balance.

The pattern of the Fed's recent open market operations has important implications for market participants. First, it should now be obvious that the Fed has not budged from the reserves-oriented operating procedures adopted October 6 of last year. From the standpoint of the Fed's long-haul effort to restrain inflation, that should be reassuring. Second, it is clear that market participants who endeavor to gauge the Fed's policy stance by reference to recent "intervention points" (the rates at which reserves are supplied or drained) risk being misled, as many were when last week's reserve miss forced rates higher.

Another implication is that the pace of corporate bond offerings should pick up again soon, after having been pared back recently due to the Treasury's refunding this week and the concern that a new and more restrictive Fed posture might force rates higher. As those fears are laid to rest, the flow of new offerings should resume its recent heavy volume. Thus, pressure on rates in that sector should continue for the near term, before beginning to abate later in the fall.

William C. Melton

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Market Yields

	8/8/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors			
with highest credit rating	11.00%	11.00%	11.75%
Effective since	7/24/80		
Discount Rate at Federal Reserve Bank	10.00	10.00	10.00
Federal Funds	9.13	10.63	10.63
Repurchase Agreements	8.88	9.50	10.25
U.S. Treasury Issues			
Bills			
3 months	8.70	8.88	9.69
6 months	9.13	9.17	9.98
1 year	9.30	9.28	9.75
Coupons			
2 years	9.65	9.61	9.30
4 years	9.98	9.90	8.99
7 years	10.50	10.00	8.99
10 years	10.75	10.65	9.00
Long Bond	10.65	10.62	8.96
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.15	9.90	10.50
3 months	9.30	9.90	10.55
6 months	9.50	10.00	10.65
1 year	10.00	10.25	10.55
Banker's Acceptances			
1 month	9.15	9.55	10.60
3 months	9.25	9.55	10.65
6 months	9.55	9.55	10.75
Eurodollar Deposits			
1 month	9.63	10.38	11.00
2 months	9.88	10.44	11.19
3 months	10.19	10.50	11.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.00	9.00	10.25
1 month	8.63	8.75	10.25
3 months	8.75	8.75	10.00
Bank Holding Companies			
1 month	8.63	8.63	10.30
Dealer Placed:			
3 months	8.63	8.50	10.20
New AA Corporate Utility Bond	12.50	12.50	9.70*
Tax Exempt			
6 month Project Notes	4.35	4.40	5.20
1 year AAA Bond	5.00	5.10	N/A
5 year AAA Bond	5.40	5.50	N/A
20 year AAA Bond	7.95	7.85	5.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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